Comments By
The City of Long Beach
as Trustee For
The State of California

M. Brian McMahon, Esq.
McMahon & Spiegel
355 South Grand Avenue
Suite 3290
Los Angeles, CA 90071
(213) 628-9800

James N. McCabe, Esq.
Deputy City Attorney
City of Long Beach
333 West Ocean Boulevard
Suite 1100
Long Beach, CA 90802
(562) 570-2211

TESTIMONY OF JAMES N. McCABE AND M. BRIAN McMAHON
FOR THE CITY OF LONG BEACH
AS TRUSTEE FOR THE STATE OF CALIFORNIA
BEFORE THE SUBCOMMITTEE ON ENERGY & MINERAL RESOURCES
RESOURCES COMMITTEE
MAY 21, 1998

Madam Chairman and Members of the Subcommittee:

We appreciate the opportunity to appear today to address H.R. 3334, the Royalty Enhancement Act of 1998. James N. McCabe is the Deputy City Attorney of the City of Long Beach, California, and M. Brian McMahon is partner in the law firm of McMahon & Spiegel, counsel to the City of Long Beach as Trustee for the State of California.

We are here today to speak against H.R. 3334. For several years, federal lessees have paid less than the fair market value for federal royalty oil. H.R. 3334 is not the solution to these underpayments, but will perpetuate those underpayments. It is not surprising that H.R. 3334 is favored by the oil industry. We believe that Mineral Management Services' proposed regulations which base royalties on spot prices which are widely used in the industry is substantially the correct approach. We support also MMS's announced intention to conduct pilot royalty-in-kind (RIK) projects with full consultation with the states and the oil industry.

We are in a unique position to be commenting on the proposed legislation. Since the early 1970's, the State of California (State) and The City of Long Beach (City) have conducted royalty-in-kind sales of their oil. The results of the State's sales since 1990 are presented in Attachment 1 and the results of the City's sales since 1993 are presented in Attachment 2. The results of these sales in the 1990's are substantially the same as the sales in the 1970's and 1980's. The winning bids on these sales have exceeded posted prices but they have been much closer to posted prices than to fair market value. See Attachment 3. The City and State have been selling their oil far longer than have any other public entities in the United States. Thus, we can provide input as no other public entity can into the likely success or not of the royalty-in-kind program proposed in H.R. 3334.

In addition to our long experience in conducting sell-offs, we bring additional insight to the likelihood of success of the RIK proposed program in H.R. 3334 because we have obtained internal documents relating to the valuation of crude oil from all of the oil companies operating in California. These documents were obtained in litigation alleging that major oil companies underpriced crude oil sold to them by the City and State. The State has received over $300 million in settlements from six oil companies in the litigation. We provided documents produced to us in litigation to an Inter-Agency Task Force comprised of members of the MMS, the Department of Energy and the Department of Commerce, whose task it was to investigate whether oil companies had underpaid royalties for federal crude oil produced in California. Based on the documents and assistance we provided, the Task Force issued a Report, May 16, 1996, concluding that the federal government had been substantially underpaid for its crude oil in California since the early 1980's. Because the State of California shares in the royalties paid for federal royalty crude oil, we want to ensure that the federal government receives fair market value for its crude oil.

THE ROYALTY-IN-KIND SALES BY THE CITY OF LONG BEACH AND THE STATE OF CALIFORNIA

The State of California has held sales of its royalty-in-kind crude oil produced in the Wilmington Oil Field which is located in the City of Long Beach and in the tidelands adjacent to the City of Long Beach, as well as its crude oil produced in oil fields in Huntington Beach, Ventura County and Santa Barbara County. The City of Long Beach has conducted sales of royalty-in-kind crude oil produced in the Wilmington Oil Field, which it holds in trust for the State of California, as well as for crude oil which it produces on shore in its own behalf. The sales contracts obligate the purchasers to take crude oil for a year to a year and a half. The contract volumes sold in those contracts range from under 100 barrels a day to slightly over 4,000 barrels per day.

The sales of royalty-in-kind crude oil have been conducted in a manner designed to achieve the highest bids possible. Prior to any sell-off, notice is given 60 to 90 days prior to the dates on which the bids are due to newspapers of general circulation in the area of the leases and to interested oil companies. Oil companies have plenty of time to decide whether to submit a bid. Winning bidders begin to take the oil about 90 days to 6 months after the bids are received, depending upon the lease.

The City and State require that bids be submitted using the posted prices in the fields involved in the sell-offs as the base price. Bids on royalty-in-kind oil are always stated in reference to posted prices. Except for rare instances, the highest bid for each of the royalty-in-kind sales is a bonus over posted price. In the very few instances in which the highest bid was equal to or barely above posted price, the sales were cancelled. The fact that bonuses have been consistently bid for the City's and State's crude oil since the early 1970's is one indication that posted prices did not represent the fair market value of California crudes. Even though the bonuses received in the bids were greater than posted prices, they were well below the fair market value of the crudes because of the unwillingness of the Major oil companies to bid competitively for crude supplies.

The participation of the Majors in these royalty-in-kind sales has been negligible. There are seven major oil companies operating in California: Texaco, Exxon, Unocal (now Tosco), Mobil, Shell, Chevron and Arco. Of those seven Majors, only Shell, Arco and Texaco have ever bid on any of the royalty-in-kind sales. Arco and Shell have never been successful bidders, as their bids have never been the highest bid on any proposed sale. Only Texaco among the Majors has successfully bid on any of the royalty-in-kind sales conducted by the City of Long Beach and the State of California. Chevron, Mobil, Exxon and Unocal have not submitted a single bid in over 25 years. Shell's bids for sell-off oil occurred only in the early 1980's.

The Wilmington Oil Field, where many of the royalty-in-kind sales take place, is in one of the choicest locations for crude oil production in the entire United States. The royalty-in-kind oil is delivered to a location which is accessible to many crude oil pipelines. Many large refineries capable of refining Wilmington crude oil are located in and around the City of Long Beach and are connected by pipeline to the royalty-in-kind oil produced in the Wilmington Field. These refineries are owned by Mobil, Texaco, Shell, Unocal (now Tosco), Chevron and Arco as well as by independent refiners. Shell owned a refinery connected by pipeline to the Wilmington Field until 1992 when Shell sold the refinery to Unocal. All of these companies have an economic incentive to purchase more California crude oil than they did. These refineries are located in one of the largest gasoline markets in the entire United States. Facilities exist to load sell-off crude oil into tankers for shipment to Northern California and even to out of state. Royalty-in-kind crude from the Wilmington field can also be shipped to the All American Pipeline and thence to Texas. The State's crude oil sell-offs in Ventura County and recently in Santa Barbara County are accessible by crude oil pipelines. Huntington Beach sell-off oil is deliverable by pipeline to the L.A. Basin refineries as well. Thus, major oil companies should be willing to bid on the State's and City's sell-off oil. But in over 25 years only three have ever submitted bids and only one has submitted a winning bid.

Internal major oil company documents produced in litigation to the City and State establish that the State's and City's crude oils and other California crudes are the most profitable refinery feedstocks in all of the major oil companies' refineries in the United States. If oil companies were behaving competitively, they would have bid on the City's and State's royalty-in-kind oil. Their decision to act noncompetitively has resulted in bids which, while higher than posted prices, are far lower than the market value of the City's and State's crude oils.

H.R. 3334

The current dispute over federal royalties which H.R. 3334 addresses must be seen as part of a larger problem. Oil companies traditionally have paid royalties to the federal government, to the states and to other royalty owners on the basis of their posted prices. Posted prices are not the result of negotiation with royalty owners but are unilaterally set by oil companies. For years oil companies have set posted prices throughout the United States below the fair market value of crude oils. Royalty owners including states and the federal government have been paid on the basis of posted prices with the result that they have been underpaid for their oil. At the same time, oil companies pay each other and some independent producers prices higher than postings for crude oil. This two level pricing (a price below fair market value paid to royalty owners and a higher price paid to oil companies and some producers) has created a need for a methodology which will ensure that the federal government will obtain market value for its royalty crude oil.

We believe H.R. 3334 will not obtain market value for federal royalty crude oil. H.R. 3334 is fatally flawed for several reasons, taken separately or together.

The first fatal flaw in H.R. 3334 is that it assumes that there is an open, competitive market for RIK oil. Our experience in California for over 25 years is that that assumption is false. In California all posters except occasionally for Texaco are unwilling to pay more than their posted prices to producers. Other companies are similarly unwilling to pay more than prices posted by their competitors. The posters have publicly stated on innumerable occasions that they will pay only their posted prices. At the same time the Majors have paid more than posted price to other Majors for crude oil.

In California, the seven major oil companies dominate the market. They control 65% of the crude oil production, and over 80% of refining and transportation of crude oil and marketing of gasoline. Except for the limited number of bids by Texaco, the Majors' refusals to bid on the State's and City's royalty-in-kind sales has resulted in sell-off bids which are lower than the fair market value of the royalty crudes for two reasons. First, only a small percentage of the market submits bids. Lower participation means less competition. Second, independent refiners who do bid have less sophisticated refineries than do the Majors and so they see less value in a barrel of California crude oil. Consequently, they bid less than what the Majors would bid if the Majors were acting competitively.

A contributing factor to the lack of competition for lease crude oil in California is private ownership by the Majors of three essential heated pipelines. The three pipelines do not operate as common carriers. California crude oil production is predominantly heavy and cannot be transported through pipelines unless the pipelines are heated or the heavy crude is blended with light crude oil or semi-refined products. Because of the relative scarcity of light crude oil and the expense of semi-refined products, heated pipelines are essential for the transportation and eventual refinery of heavy Califronia crude oil. Chevron, Mobil and Texaco, who own the three heated private pipelines, require that independent producers sell their crude oil to them as a condition of access to the pipelines. The pipeline owners can dictate the prices paid for the crude. Some of the federal royalty oil in the Midway-Sunset oil field in the San Joaquin Valley is tied into the proprietary Mobil pipeline and therefore is captive to Mobil. The pipeline owners have no incentive to pay a market price for crude oils tributary to the pipelines because they know that they have a lock on such crude oils.

We have not seen any evidence that the Majors who post prices are willing to vary from their long-standing practice in California of paying only posted prices for royalty crude oil. Moreover, we have not seen any evidence that the Majors will compete to become qualified marketing agents. The likelihood is that the federal government will not receive fair market value for its California crude production in RIK sales.

A second fatal flaw in H.R. 3334 is that it requires the federal government to take in kind and sell all its royalty oil leaving no discretion to refuse to sell even when the bids are well below the market value of the crudes. The Bill would require the federal government to sell all of its crude oil, no matter how low a price is offered for its crude oil. In contrast to H.R. 3334, the California State Lands Commission and the City of Long Beach have authority to refuse bids for their royalty-in-kind oil if the bids are too low. H.R. 3334 is flawed also in comparison with current federal statutes. Under 30 U.S.C. §192, the Secretary of Interior has authority to refuse bids on federal royalty-in-kind oil.

The failure in the proposed legislation to grant any discretion to the Secretary of Interior will result in some extremely low bids which are well below market price for federal royalty oil. Our own experience is that the discretionary right to refuse bids that are too low or not to take and sell certain crude oils is an essential component of any RIK program.

We also object to the set-aside of 40% of federal royalty oil for independent refiners. Section 12(c) would use the lowest prices to value this oil. Any competition which exists for federal RIK oil would be dramatically reduced if 40% is set aside for independent refiners. We see no justification for this gratuitous benefit for independent refiners. Under the present statute (43 U.S.C. §1352) small refiners must pay fair market value for the federal royalty crude oil, which is the same price paid by the Majors. Under Sect. 12(a)(4)(b) of the proposed legislation, independent refiners would pay less than fair market value for royalty oil. The effect of this set-aside for independent refiners will be to reduce royalties paid to the federal government and to the states.

H.R. 3334 is flawed for additional reasons. It shifts significant costs that are presently borne by lessees, their affiliates or downstream associates to the federal government and to the States which share in federal royalties. For example, the Bill would require the federal government to incur the additional cost of placing royalty oil in a condition acceptable to refiners.

Under current regulations, 30 CFR §206.102(h)(i), and the Bill, Section 4(a), the lessee is required to place oil in marketable condition at no cost to the government. Under current regulations "marketable condition" means a condition acceptable to a purchaser, 30 CFR §206.101; but under the Bill, marketable condition means a condition acceptable to the transporter of production, Section 2(18). Oil and gas which meets the transporter's standards do not necessarily meet the standards of purchasers. This will be particularly true when the transporter and the lessee are one and the same or affiliated with one another. The result will be that the government will have to pay to place the oil and gas in a condition which meets the requirements of purchasers. This is a concern to California. In California, offshore crude production is moved by pipline to a central processing center to remove water and other impurities. The water and other impurities are acceptable to the pipeline owners but not to refiners who will purchase the oil. Under the Bill but not under current regulations, the federal government will have to pay for costs to remove water and other impurities from the crude oil.

We believe for all of the above reasons that H.R. 3334 is fatally flawed. Even if all the other deficiencies would be cured, the failure of the Majors to act competitively for royalty crude and the lack of any discretion by the Secretary mandate rejection of H.R. 3334.

MMS' Proposed Regulations

MMS's proposed regulations are designed to ensure that the federal government and the states which share in federal royalties obtain fair market value for royalty crude. Although we do not agree with all of the details in the regulations proposed by MMS, we believe MMS's approach is substantially correct. It is far more likely than the RIK program contained in H.R. 3334 to achieve fair market value for federal royalty oil.

MMS proposes to determine the market value of royalty crude sold in arm's-length sales at the prices received for the crude oil sales. For royalty crude which is not sold arm's-length, MMS first values the crude at the nearest market center and then deducts the cost to transport crude from the lease to the market center. The lessee does not bear the transportation cost.

MMS's approach is not novel. The court in United States v. General Petroleum, 73 F. Supp. 225 (S.D. Ca. 1946), used a netback method to determine the market value of federal royalty crude oil at Kettleman Hills, CA. According to the court, the lease value of crude was the value at the nearest market center less the cost to transport it from the lease to the market center. In that case the oil companies maintained that they used a net back method in setting posted prices. The oil companies contended that they set posted prices by first determining the value of crudes in their refineries and then by deducting transportation costs to transport crude from the leases to the refineries.

The proposed MMS regulations base royalties on currently existing, internationally recognized, real crude oil prices which oil companies use every day: West Texas and Louisiana spot prices for crudes in the Gulf Coast area, Alaskan North Slope (ANS) spot prices in California and other crude prices in the Rocky Mountain area. These spot prices are a valid basis for federal royalties because they derive from purchases and sales of a large number of barrels of crude oil and can be publicly ascertained on a daily basis.

Major oil companies in California have purchased and sold ANS crude oil in Long Beach at prices which are consistently well above posted prices of comparable California crudes. ANS constitutes approximately 40% of refinery feedstock in California. ANS competes with California crudes in California refineries. The spot price of ANS is derived from the sale of a large number of barrels of ANS in California. The sales price of ANS in Long Beach is a perfectly legitimate basis for valuing federal royalty oil in California.

We fully support MMS's efforts to revise regulations to base royalties on spot prices which are used extensively throughout the industry. We support also MMS's announced intention to conduct pilot RIK programs. We strongly urge the Subcommittee to defer action on H.R. 3334 until the results of MMS's pilot programs are completed. The RIK program proposed in H.R. 3334 is untried. The only RIK program conducted by MMS was a failure. Caution suggests that before MMS is required to take and sell all of its crude, pilot programs be established to determine whether such wholesale programs will be successful and under what conditions.

Thank you Madam Chairman and members of the Subcommittee. This concludes our prepared remarks. We would be pleased to answer any questions that you may have.

doc59.doc

STATE LANDS COMMISSION
ROYALTY OIL SALES
1990 - Present

LOCATION	FIELD	CONTRACT #	VOLUME B/D	BIDDER	** BID $/bbl.	PURCHASER	SALE DATE
Huntington Beach	Huntington Beach Offshore	PRC 7447	265	*Golden West	$0.471	Golden West	8/14/90
				Texaco	$0.4215		
				Ultramar	$0.30		
		PRC 7559	399	* Fletcher	$0.576	Fletcher	7/16/91
				Golden West	$0.313		
				Enron	$0.285		
		PRC 7887	800	EOTT	$0.2605	EOTT	2/15/96
		PRC 7922	1,000	EOTT	$0.261	EOTT	9/27/96
		PRC 7963	934	EOTT	$0.255	EOTT	2/20/97
		PRC 8021	1,107	Paramount	$0.2501	Paramount	2/18/98
		PRC 7498	34	* Texaco	$0.7215	Texaco	8/16/90
				Golden West	$0.679		
		PRC 7562	280	* Enron	$0.339	Enron	7/17/91
				Fletcher	$0.326		
				Ultramar	$0.315		
				Golden West	$0.313		
		PRC 7460	500	Texaco	$0.3169	Texaco	9/26/90
		PRC 7595	280	Fletcher	$0.286	Fletcher	10/3/91
		N/A	450	No Bids	None	N/A	5/7/97

* Successful Bidder
** Bonus over highest posted price in the field

LOCATION	FIELD	CONTRACT #	VOLUME B/D	BIDDER	** BID $/bbl.	PURCHASER	SALE DATE
Long Beach	Wilmington	PRC 7539	250	* Texaco	$0.521	Texaco	4/25/91
				Ultramar	$0.405		
		PRC 7894	600	* Ultramar	$0.655	Ultramar	3/15/96
				EOTT	$0.651		
				Edgington	$0.625		
				Texaco	$0.5867		
				Bravo	$0.58		
				Huntway	$0.361		
		PRC 7964	534	* EOTT	$0.750	EOTT	2/20/97
				Huntway	$0.6350		
		PRC 8022	600	Paramount	$0.265	Paramount	2/18/98
Long Beach	Belmont Offshore	PRC 7537	78	Ultramar	$0.25	Ultramar	4/24/90
Santa Barbara	Carpinteria	N/A	367	None	No Bids	N/A	1/24/90
Santa Barbara	Ellwood	PRC 7514	165	Huntway	$0.251	Huntway	2/20/91
Ventura	Rincon	PRC 7558	130	Texaco	$0.2725	Texaco	7/23/91
Santa Barbara	South Ellwood	PRC 7514	780	Huntway	$0.251	Huntway	2/20/90
		PRC 7538	1,465	Enron	$0.30	Enron	4/17/91

* Successful Bidder
** Bonus over highest posted price in the field

"CITY OF LONG BEACH"
"ROYALTY OIL SALES'
"1993-PRESENT"

CONTRACT	TRUST	TERM BEGIN	TERM END	VOLUME (B/D)	BIDDERS	BASE PRICE	BONUS ($/B)	ACCEPT (B/D)	REMARKS
*LBU, City Townlot Area	No	10-1-93	10-1-94	140	No Bid	Avg,4,CMUT			Rebid
LBU, City Townlot Area	No	10-1-93	10-1-94	140	Ultramar	Avg,4, CMUT	$0.05	Yes	
Upland Oil, FB IV & V	Yes	2-1-94	2-1-95	600	Huntway	Avg,4,CMUT	$0.235	Yes	
Signal Hill, West & East Units	No	3-1-94	3-1-95	140	Eott	Avg,4,CMUT	$0.00	Yes	
LBU, TR1, 7% Segment	Yes	9-1-94	3-1-96	3,000	Edgington	H,4,CMUT	$0.135	No	SLC Rejected Bid
LBU,.TR1, 5.5% Segment	Yes	9-1-94	3-1-96	2,300	Huntway	H,4,CMUT	$0.175	No	SLC Rejected Bid
					Edgington		$0.125		
LBU, TR1, 10% Nonop Con Hondo	Yes	3-1-94	3-1-95	4,000	Texaco	Avg,4, CMUT	$0.361	Yes	Assign to Arco 3-1-95
					Koch		$0.32		
					Bravo		$0.31		
					Ultramar		$0.25876		
					Edgington		$0.215		
					Eott		$0.11		
LBU City Townlot Area	No	10-1-94	10-1-95	160	Huntway	Avg,4, CMUT	$0.376	Yes	
Upland Oil, FB IV & V	Yes	2-1-95	2-1-96	700	Texaco	Avg,4, CMUT	$0.515	Yes	
Signal Hill West & East Units	No	3-1-95	3-1-96	130	Eott	Avg,4, CMUT	$0.00	Yes	
LBU, TR1, 7% Segment	Yes	9-1-95	3-1-97	2,800	Eott	H,4, CMUT	$0.459	Yes	
					Edgington		$0.375		
LBU, TR1, 5.5% Segment	Yes	9-1-95	3-1-97	2,200	Eott	H,4, CMUT	$0.516	Yes	
					Edgington		$0.260		
LBU City Townlot Area	No	10-1-95	10-1-96	160	Eott	Avg,4, CMUT	$0.55	Yes	
					Huntway		$0.4171		
Upland Oil, FB IV & V	Yes	2-1-96	2-1-97	700	Texaco	Avg,4, CMUT	$0.566	Yes	
Signal Hill West & East Units	No	3-1-96	3-1-97	150	Eott	Avg,4, CMUT	$0.001	Yes	

* *CONTRACT NOT IN EFFECT, SEE REMARKS.*

BASE PRICE: H=highest, AVG=Average, 4=Four Fields (Wilmington, Long Beach, Huntington Beach & Inglewood), WILM=Wilmington, CMUT= Chevron, Mobil, Union & Texaco.

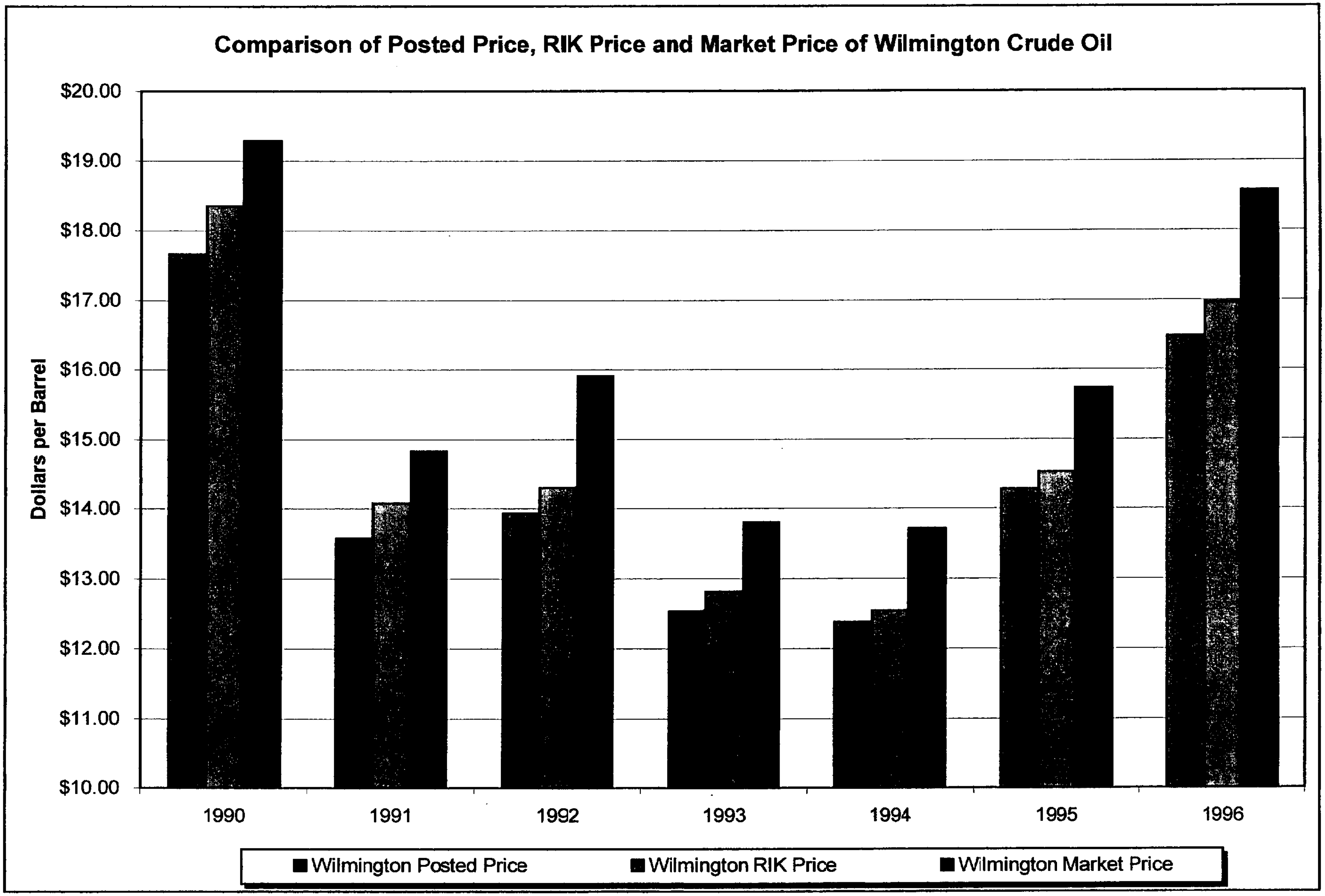
ATTACHMENT 2

"CITY OF LONG BEACH"
"ROYALTY OIL SALES'
"1993-PRESENT"

CONTRACT	TRUST	TERM BEGIN	TERM END	VOLUME (B/D)	BIDDERS	BASE PRICE	BONUS ($/B)	ACCEPT (B/D)	REMARKS
LBU, TR1, 7% Segment	Yes	3-1-97	9-1-98	2,700	Paramount	H,4, CMUT	$0.7562	Yes	
					Eott		$0.551		
					Edgington		$0.3675		
LBU, TR1, 5.5% Segment	Yes	3-1-97	9-1-98	2,100	Paramount	H,4, CMUT	$0.7562	Yes	
					Eott		$0.593		
					Edgington		$0.5675		
LBU, City Townlot Area	No	10-1-96	10-1-97	160	Paramount	Avg,4, CMUT	$0.476	Yes	
					Edgington		$0.375		
					Huntway		$0.285		
Upland Oil, FBIV & V	Yes	2-1-97	2-1-98	600	Texaco	Avg,4, CMUT	$0.681	Yes	
Signal Hill, West & East Units	No	3-1-97	3-1-98	160	Eott	Avg,4, CMUT	$0.001	Yes	
LBU, City Townlot Area	No	10-1-97	10-1-98	350	Texaco	Avg,4, CMUT	$0.68514	Yes	
					Eott		$0.5601		
					Huntway		$0.261		
Upland Oil, FB IV & V	Yes	2-1-98	2-1-99	700	Huntway	Avg,4, CMUT	$0.596	Yes	
LBU, TR1, 7% Segment	Yes	9-1-98	3-1-00	2,500	Bravo	H,4, CMUT	$0.28		
					Eott		$0.5252		
					Paramount		$0.4602		
LBU, TR1, 5.5% Segment	Yes	9-1-98	3-1-00	2,000	Bravo	H,4, CMUT	$0.44		
					Eott		$0.4242		
					Paramount		$0.3801		
Signal Hill West & East Units	No	3-1-98	3-1-99	160		Avg,4, CMUT			

* *CONTRACT NOT IN EFFECT, SEE REMARKS.*

BASE PRICE: H=highest, AVG=Average, 4=Four Fields (Wilmington, Long Beach, Huntington Beach & Inglewood), WILM=Wilmington, CMUT= Chevron, Mobil, Union & Texaco.



Sources: Texaco Posted Price Bulletins, Platt's, Price of RIK Sales by City of Long Beach and State of California.
Market value based on ANS spot price in Long Beach adjusted for gravity using the CA posted price gravity differential.

Attachment 3

COPY

KATHLEEN CONNELL
Controller of the State of California

February 26, 1998

Ms. Lucy Querques-Denett
Associate Director
Minerals Management Service
U.S. Department of the Interior
1849 C Street, N.W., Room 4228
Washington, DC 20240

Dear Ms. Denett:

On behalf of the California State Controller's Office (SCO), I want to thank you for providing us with a copy of the industry proposed "Federal Oil and Gas Royalty Certainty Act of 1998." At your request, we reviewed the industry proposal. This letter provides the SCO's initial views on whether the proposed Act will serve the interests of the State of California.

The SCO is uniquely qualified to comment on the industry proposal, having a long history of involvement with and oversight of the federal royalty management program. The State Controller, as a representative on the State Lands Commission, has also been involved in the management of state oil-producing properties, including sales with in-kind oil. As a delegate of the Secretary, we have performed audits of the federal lessees operating within California and have actively participated in the development of audit strategies and royalty policies. Through this experience and oversight of the Long Beach cases, we have gained considerable knowledge concerning the trading practices of the oil and gas industry in California. As the office responsible under California law for the accounting and collection of revenues, our guiding principle is to assure the receipt of the full amount due to California's public school system and other public beneficiaries from federal mineral revenues. The SCO's expertise, interest, and independence are unquestionable.

The industry proposal appears to be designed to lock in the very practices industry has used in the past to avoid paying the full fair market value for production. This is particularly apparent from the provisions requiring lease-by-lease "qualified marketing agents" (QMA) and permitting self-dealing companies to act as QMAs for the government. Revenues will be further decreased by the added allowances and payments that the government would be required to make. When these provisions are coupled with the requirement that the government continue to honor royalty

MAILING ADDRESS P.O. Box 942850, Sacramento, CA 94250
SACRAMENTO 300 Capitol Mall, Suite 1850, Sacramento, CA 95814 (916) 445-2636
LOS ANGELES 600 Corporate Pointe, Suite 1150, Culver City, CA 90230 (310) 342-5678

rate reductions rather than the lease rate, the United States may be considered lucky to break even in many lease situations. In this regard, it is of note that many of the largest companies operating in California are currently paying as low as a one or two percent royalty rate, which is being applied on some of the most prolific federal leases in the State. The opportunity offered the states to perform the wholly ministerial tasks outlined for potential "delegation" are simply not worth the high cost of the industry proposal.

We wish to emphasize that the SCO has always been and remains open to consideration of better ways to administer the royalty management program and to changes that foster reasonable accommodation of the interests of participants in the program, including industry. The industry proposal, however, is neither a better way nor a reasonable accommodation. There is nothing in the proposal that is a positive for the State of California. Indeed, the only certainty promoted is the certainty of continued and increased revenue loss.

Again, thank you for the opportunity to express our views. If you would like to meet to discuss our analysis in greater detail, please do not hesitate to contact us.

Sincerely,

Julie Bornstein

JULIE BORNSTEIN
Chief Deputy State Controller, External Affairs
State Controller's Office

JB:RF:wq

cc: Chief Deputy State Controller, Finance
Rick Chivaro, Chief Counsel, State Controller's Office
Carol Nebel, Chief, Division of Audits, State Controller's Office